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COMPTROLLER

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MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
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SUBJECT: Revised Policy Pertaining to General Property, Plant and Equipment

This memorandum issues revised accounting policy pertaining to General Property, Plant and Equipment (PP&E). The revised policy is contained in three separate attachments. Attachment 1 addresses the Department's depreciation policy for capitalized improvements to General PP&E. This policy has been modified and clarified to make it more consistent with the federal accounting standards. Attachment 2 provides revisions to the Department's Standard Recovery Periods Table that is used in computing depreciation of General PP&E. This table has been modified to clarify the types of property that apply to each recovery period, to include permitting depreciation over less than 5 years. Attachment 3 addresses the Department's asset recognition policy under the Preponderant Use Policy. This policy has been changed to make recognition of General PP&E consistent with the federal accounting standards.

This office is in the process of revising the "DoD Financial Management Regulation" (DoD 7000.14-R) to incorporate the accounting principles, standards and reporting requirements of the Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment." The policy issued by this memorandum will be included in the revision to Chapter 6 of Volume 4.

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William J. Lynn

Attachments

DEPARTMENT OF DEFENSE
GENERAL PROPERTY, PLANT AND EQUIPMENT (PP&E)
POLICY ON DEPRECIATION OF IMPROVEMENTS

Policy Change 1. The Department of Defense (DoD) accounting policy for the depreciation of capitalized improvements to General Property, Plant and Equipment (PP&E) is being revised to make it more straightforward and easier to implement. The revised policy for capitalized improvements to General PP&E is less complex and easier to program into automated property systems. In addition, the definition of a capitalized improvement has been clarified to better ensure consistency with federal accounting standards.

Current Policy. The current policy for improvements to General PP&E is contained in paragraph 58.E.7 of Volume 11B of the DoD Financial Management Regulation (DoD 7000.14-R). Improvements and upgrades that increase the capacity or operating efficiency of an existing capital asset, and for which the cost is equal to or greater than the capitalization threshold, should be capitalized even though the improvement or upgrade may not extend the useful life of the asset. The depreciation schedule of existing capital assets shall be revised to include the acquisition cost of a capitalized improvement or upgrade. Below are the criteria to be used to determine whether the useful life of the original asset should be revised.

1. If the cost of the improvement or upgrade is greater than 50 percent of the net book value (original acquisition cost less accumulated depreciation) of the existing asset, then the improvement or upgrade is analogous to the purchase or manufacture of a new asset. Accordingly, the improvement or upgrade cost shall be added to the current net book value of the existing asset and result in a new basis (recorded cost) for depreciation over the useful life (see the standard useful lives guidance in the depreciation policy issued by the Under Secretary of Defense (Comptroller) memorandum, dated March 26, 1998) of the asset starting from the month that the improvement or upgrade became operational.

2. If the cost of the improvement or upgrade is less than 50 percent of the net book value (original acquisition cost less accumulated depreciation) of the existing asset, then the cost of the improvement or upgrade is depreciated over the remaining useful life of the existing asset.

Revised Policy. Consistent with the Statement of Federal Financial Accounting Standards (SFFAS) No. 6, “Accounting for Property, Plant and Equipment,” costs to improve PP&E shall be capitalized only when the improvement increases a General PP&E asset’s capacity, size, efficiency, or useful life. In addition, the cost of an improvement shall be capitalized only when the cost of the improvement equals or exceeds the DoD capitalization threshold (regardless of funding source). Applicable improvements shall be capitalized and depreciated separately from the General PP&E asset improved. The SFFAS No. 6, requires that improvements be capitalized and depreciated over the remaining useful life of the associated General PP&E. The DoD policy recognizes that improvements are made to many assets that are substantially or fully depreciated. Improvements that do <u>not</u> increase an asset's capacity, size, efficiency, or useful life, regardless of the cost of the improvement, shall be expensed. Policy applicable to specific types of property follows:

a. <u>Improvements to Real Property</u>. Improvements to General PP&E real property (including multi-use heritage assets), that equal or exceed the DoD capitalization threshold, shall be individually capitalized within real property systems and depreciated over the applicable DoD standard recovery period, as detailed in the table contained in Policy Change 2, "DoD Recovery Periods for Depreciable General PP&E Assets," of this issuance. As indicated in the table, improvements to fences, roads, bridges, sewers, and other utilities shall be depreciated over 10 years, and improvements to buildings and other structures shall be depreciated over 20 years.

b. <u>Improvements to Personal Property</u>. Improvements to General PP&E personal property that increase an asset's capacity, size, efficiency, or useful life, when the costs equal or exceed the DoD capitalization threshold, shall be individually recorded (capitalized) within personal property systems and depreciated over the applicable DoD standard recovery period, as detailed in the table contained in Policy Change 2, "DoD Recovery Periods for Depreciable General PP&E Assets." As indicated in the table, improvements to personal property shall be depreciated over 5 years.

c. <u>Maintenance and Repair</u>. Maintenance and repair costs are <u>not</u> considered capitalized improvements, regardless of whether the costs equal or exceed the DoD capitalization threshold. Maintenance and repair costs associated with personal property (contracts for equipment and software for example) shall be expensed. When repairing a facility, the components of the facility may be repaired by replacement, and the replacement can involve upgrading to current standards and codes. For example, a roof can be repaired by replacement, using a better quality and longer life shingle that meets current building codes.

d. <u>Per Unit Costs</u>. The cost of improvements to more than one General PP&E asset, when performed under a single contract or work order and that cannot be specifically identified by asset, shall be capitalized only if the allocated cost per General PP&E asset equals or exceeds the DoD capitalization threshold.

(1) For example, assume a contractor is paid $200,000 under one contract to replace the air conditioning units in 10 buildings with more efficient air conditioning units. Since the cost per building is $20,000, and $20,000 is below the DoD capitalization threshold, the amount is not capitalized. Even though an improvement was made, the DoD capitalization threshold was not met. However, if the same amount ($200,000) were paid for two buildings, the amount would be capitalized because the capitalization threshold would have been met. In this example, $100,000 would be recorded against each building.

(2) When more than one improvement is made to a single building, facility or structure, and the improvements are part of one overall effort to increase the facility's capacity, size or useful life, the sum of the costs of the improvements shall be capitalized. This is so even though the efforts may be funded separately. For example, assume three separate contracts are obtained to improve a building. One contract modifies the exterior of the building for $90,000, the second contract modifies the interior of the facility for $200,000 and a third contract replaces the heating and air conditioning system for $35,000. The sum of three improvements ($325,000) is capitalized since the three individual projects are part of a single effort to improve the building.

Implementation Date. The revised policy for improvements is applicable to all General PP&E assets improved after August 1, 1999. The DoD Components shall not adjust the depreciation schedules of assets that have been previously improved.

DEPARTMENT OF DEFENSE
GENERAL PROPERTY, PLANT AND EQUIPMENT (PP&E)
POLICY ON DEPRECIATION RECOVERY PERIODS

Policy Change 2. The Department of Defense (DoD) accounting policy for depreciation is being revised to permit the depreciation of General Property, Plant and Equipment (PP&E) assets over a recovery period of less than 5 years. This change is consistent with the Federal Accounting Standards Advisory Board's SFFAS No. 6, "Accounting for Property, Plant, and Equipment." In addition, the DoD Standard Recovery Periods Table is being revised to clarify the types of property that apply to each recovery period.

<u>Current Policy</u>. For purposes of computing depreciation on General PP&E, the DoD Standard Recovery Periods Table, as previously issued, prescribes recovery periods of 5, 10, 20, and 40 years, and does not permit depreciation over a period of less than 5 years.

<u>Revised Policy</u>. If a DoD Component determines that a General PP&E asset, when acquired, meets the DoD capitalization threshold and has a useful life of at least 2 years, but less than 5 years, the Component can elect to depreciate the asset over a recovery period that reflects its useful life (2-4 years). The DoD Component making this election must document the basis for that decision and cannot change the recovery period once depreciation has commenced. It is expected that few types of General PP&E, other than software, will be depreciated over less than 5 years. The revised DoD Standard Recovery Periods Table is on page 2 of this attachment.

Any requests for a deviation from the DoD Standard Recovery Periods Table must be submitted to the Office of the Under Secretary of Defense (Comptroller) for approval. Such requests must be specific to a class or type of asset and must be supported by information that indicates a life expectancy significantly different than that allowed for in this policy. Previously approved exceptions are not affected by the revised policy.

<u>Implementation Guidance</u>. The revised DoD Standard Recovery Periods Table is applicable to all General PP&E assets acquired after August 1, 1999. For Working Capital Fund Activities, this policy shall be effective for all General PP&E assets acquired on or after October 1, 2000. The DoD Components shall not attempt to adjust the depreciation schedules of assets currently on-hand.

DoD STANDARD RECOVERY PERIODS
FOR DEPRECIATING GENERAL PP&E

Description of General PP&E Assets	Recovery Period
General Purpose Vehicles (Includes Heavy Duty Trucks & Buses), ADP Systems and Hardware (Computers and Peripherals), High-Tech Medical Equipment, Equipment Used in RDT&E, Radio and Television Broadcasting Equipment, and Software** Improvements to personal property (equipment and machinery)	5 Years*
All Other Equipment and Machinery, and Software** -- Improvements to Fences, Roads, Bridges, Sewers and other Utilities, Ship and Railroad Wharves and Docks, Dry Docks, Fuel Storage Facilities, etc.	10 Years
Vessels, Tugs, Barges, and Other Similar Water Transportation Equipment (non-National Defense PP&E vessels/ships) Steam (12.5K pounds per hour or more) and Electric Generation (500 Kilowatt or more) Equipment and Other Utilities Fences, Roads, Bridges, Sewers and Other Utilities, Ship and Railroad Wharves and Docks, Dry Docks, Fuel Storage Facilities, etc. -- Improvements to Buildings, Hangars, Warehouses, Air Traffic Control Towers, and Other Real Property Structures	20 Years
Buildings, Hangers, Warehouses, Air Traffic Control Towers, and Other Real Property Structures	40 Years
Improvements to Leased Buildings and Other Real Property	Remainder of Lease Period

* A recovery period of less than 5 years is permitted, when the acquiring DoD Component is certain that the useful life of an asset is at least 2 years but less than 5 years. In such instances, the recovery period shall be the known useful life (2-4 years, as appropriate).

** Depending on the nature of the software, it can be depreciated over a period of less than 5 years, 5 years or 10 years. The determining factor should be the actual estimated useful life of the software consistent with that used for planning the software's acquisition.

DEPARTMENT OF DEFENSE
GENERAL PROPERTY, PLANT AND EQUIPMENT (PP&E)
POLICY ON PREPONDERANT USE

Policy Change 3. The Department of Defense (DoD) Preponderant Use Policy is being revised to add a fourth criterion to be used when determining when a DoD Component must recognize General Property, Plant and Equipment (PP&E) for accounting and financial statement reporting purposes. This new criterion utilizes materiality as a determining factor when the preponderant use of General PP&E requires recognition of the General PP&E for accounting and financial statement reporting purposes.

The Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Standards," states that each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. The DoD policy on preponderant use was originally developed to facilitate full costing as envisioned by the SFFAS No. 4. However, materiality, which is integral to applying the standard, was not considered in developing the current preponderant use policy. The SFFAS No. 4 states that the recognition of full cost is limited to material items that are significant to the receiving entity and form an integral or necessary part of the receiving entity's output. The standard further states that broad and general support services provided by an entity to all or most other entities should not be recognized unless such services form a vital and integral part of the operations or output of the receiving entity. To comply with the intent of the SFFAS No. 4, the DoD Preponderant Use Policy has been revised.

<u>Current Policy</u>. When the preponderant user of an asset is not the titleholder or the DoD Component that financed the asset, the preponderant user, and only the preponderant user, must report that asset for accounting and reporting purposes, if all three of the following criteria are met.

1. The General PP&E asset must embody a probable future benefit that will contribute to the DoD Component's operations. For example, a building on a military installation used by a Defense agency provides space for that agency's operations, allowing the Defense agency to achieve its mission.

2. The DoD Component that reports the General PP&E asset must be able to obtain the benefit and control access to the benefit inherent in the asset.

3. The transaction or event giving a DoD Component the right to, and control over, the benefit of a General PP&E asset must have already occurred.

<u>Revised Policy</u>. A fourth criterion has been added, which also must be met when determining which DoD Component must recognize a General PP&E asset for accounting and reporting purposes. This new criterion addresses materiality as a determining factor in the recognition of a

General PP&E asset owned by one DoD Component, but predominately used by another Component.

4. DoD Components shall only report predominately used General PP&E assets owned by other DoD Components when the cost of those assets, taken as a whole, are material to the predominant user Component's financial statements. Specific examples below illustrate how this policy should be implemented.

   a. <u>Military Departments – Non-Working Capital Fund</u>. A Military Department generally shall not recognize and report facilities that they occupy on another Military Department's installation. For example, if the Air Force is a tenant on an Army installation, and the Air Force is the predominant user of a building(s) on that installation, the Army should report the buildings on the Army's financial statements--not the Air Force. This policy recognizes that the Military Departments routinely use each other's facilities in the normal course of carrying out their missions, and the net effect of this cross-use of facilities is not material to the Military Department's financial statements.

   b. <u>Defense Agencies – Non-Working Capital Fund</u>. The Defense Agencies that produce financial statements and/or are included in the DoD Consolidated Financial Statements generally must recognize and report the facilities used in their operations. The facilities are material to the performance of their mission. Most facilities used by the Defense Agencies are owned by, or titled to, the Military Departments. These facilities are significant to the operation of the agencies, and form an integral or necessary part of their output. As such, these facilities are material to the Defense Agencies' financial statements and shall be reported on the financial statements of the Defense Agencies and excluded from the financial statements of the Military Departments.

   c. <u>Working Capital Funds</u>.

      (1) <u>General</u>. Facilities used by Working Capital Fund (WCF) activities, when the WCF activity is the preponderant user of those facilities (both those of the Military Departments and the Defense Agencies), should be reported and depreciated on the appropriate Military Department WCF financial statement.

      (2) <u>Preponderant Use and Improvements</u>. The WCF activities funding capital improvements to facilities in which they are not the preponderant user, shall report and depreciate those improvements on their financial statements. For example, if the Defense Logistics Agency (DLA) occupies a facility with other Army activities, has the least square footage, and makes a capital improvement of $250,000 to the facility, the Army should record the capital improvement in its property records, but the DLA should report and depreciate the improvement on its financial statements.

d. Medical Facilities and Equipment. The preponderant use policy outlined above shall not apply to DoD medical activities. While most of the funding for medical activities is centralized through the Office of the Under Secretary of Defense (Health Affairs) (OUSD(HA)), the OUSD(HA) does not exercise command and control authority over those funds or the related medical activities. Hospitals, clinics, and other medical facilities typically are located on a military installation or otherwise are under the command and control of one of the Military Services. The essence of the medical mission of these facilities is to serve the personnel and families, working at or living near that installation. Therefore, the military installation is the preponderant user of the medical facility, and all related General PP&E shall be reported on the financial statements of the Military Department that owns the installation upon which a medical facility resides. This policy is applicable to General PP&E purchased with General Funds regardless of Department Fund Code (e.g., TI 21 or TI 97).

Implementation Guidance. The revised policy is effective August 1, 1999 and shall be used for the reporting of General PP&E in the FY 1999 financial statements. In order to facilitate the reporting required by paragraph 4.b. and 4.c., above, Military Departments in coordination with the individual Defense Agencies, must identify the General PP&E that should be reported by the Defense Agency. That information should be provided to both the applicable Defense Agency and the Defense Finance Accounting Service Indianapolis Center. It is a joint responsibility between the Military Departments and the Defense Agencies that no duplicate reporting of General PP&E occurs.